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No. 87-1321

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

LOMBARDFIN S.p.A. and PAOLO MARIO LEATI,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONERS LOMBARDFIN S.p.A. AND PAOLO MARIO LEATI

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I

PETITIONERS WERE NEVER SERVED WITH PROCESS AND THE JUDGMENT TAKEN AGAINST THEM IS A DENIAL OF DUE PROCESS

Petitioners were never served with any summons or complaint, and the only notice they ever received that the SEC intended to include them as defendants was seven days before trial, when they received a copy of a motion requesting leave to amend the

complaint to name them as defendants. Thereafter, no summons or complaint was ever served on them. Instead, the court granted the SEC's motion to amend and immediately thereafter, without any further notification to petitioners, commenced the trial, which lasted less than a day.[1]

Petitioners were denied their constitutional rights of due process, and the judgment, taking more than $2,000,000 from them as well as subjecting them to serious administrative sanctions, must be vacated. If this ruling is allowed to stand, it will provide precedent for other plaintiffs, both governmental and private, to avoid the long-standing constitutional requirement of personal service in *in personam* actions where the plaintiff has the defendant's name and address.

A. Assertion Of Jurisdiction Was Improper Where Defendants Were Not Apprised Of Their Status As Defendants

The SEC and the courts below purport to justify this deprivation of property without due process by claiming that the *International Herald Tribune* publication gave the petitioners notice of the pendency of the action and they chose not to appear. (Pet. App. A20, A73; SEC Br. at 8)[2]. This claim, however, confuses notice of pendency of an action with the requirement to apprise an individual that he is called upon to defend himself in the action. Leati and Lombardfin did have notice that the action existed. They did not, however, have any knowledge that they were intended defendants and, thus, had no notice of any obligation to defend.

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[1] Obviously, as a pleading amendment, the pleading was required to be served on petitioners and the new defendants given time to appear and respond. *See* Fed. R. Civ. P. 5 and 15. There was no court order to the contrary.

[2] References to "Pet. App." are to the Petitioners' Appendix; references to "Pet." are to Petitioners' Petition For A Writ Of Certiorari; references to "SEC Br." are to the SEC's Brief in Opposition To A Writ Of Certiorari; references to "App. Br." are to Petitioners' Appellants' Brief in the Second Circuit Court of Appeals; references to "SEC App. Br." are to the SEC's Brief as Appellee in the Second Circuit Court of Appeals.

Even if they had seen the publication in the *International Herald Tribune*, as the SEC now contends by reference to matter outside the record below,[3] that publication did not give them notice that they were defendants. (*See* Pet. App. A106-A107). On the contrary, since the SEC knew their names and addresses and knew of their involvement in the subject trades, and indeed, at that very time was in communication with petitioners' counsel on this matter, Leati and Lombardfin were entitled to conclude that the SEC would have named them personally if they were intended to be defendants in that action. Even in the absence of their communication with the SEC, Leati and Lombardfin were entitled to rely on the theretofore untarnished certainty of the constitutionally mandated service of a summons, personally or by mail, to give them notice that they were defendants and their property was at risk.

Moreover, even actual notice of one's status as a defendant is irrelevant to the jurisdiction issue if the individual sought to be brought within the court's power is not properly served. *E.g.*, *Sieg* v. *Karnes*, 693 F.2d 803, 807 (8th Cir. 1982). There is no obligation on the part of a person who has not been properly served with process to answer the complaint or otherwise to appear in an action. *Wuchter* v. *Pizzutti*, 276 U.S. 13, 24 (1928).

B. The Trial Court's Order Directing Service Of A Summons By Publication Did Not Create *In Personam* Jurisdiction

The SEC does not dispute the clear holding of *Mennonite Board of Missions* v. *Adams*, 462 U.S. 791 (1983), that service by publication is impermissible when the name and address of the defendant are reasonably ascertainable. It concedes that it knew their names and addresses. (SEC App. Br. at 50). Further, it knew of Lombardfin's involvement in the purchases of St. Joe

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[3] The SEC referred to affidavit statements purporting to evidence that Leati and Lombardfin received a copy of the newspaper publication (SEC Br. at 8-9 n.5, 15-16), which it had sought to introduce below in a motion to supplement the record. The motion was denied by the Court of Appeals. (Pet. App. A18 n.6).

securities (*see* Pet. at 4, 12 n.8), including Tome's telephone contact with Lombardfin, at the time it sought the trial court's order permitting service by publication.[4] The SEC contends only that it did not know that Leati and Lombardfin were "culpable" (SEC Br. at 5), having been allegedly misled by Leati's statement in his affidavit that he and Lombardfin were innocent of trading on the basis of nonpublic information. They still maintain their innocence and maintain that the finding of liability below is unsupported by the evidence and is clearly erroneous.[5] *Mennonite* makes no exception to its "*per se* rule against constructive notice," 462 U.S. at 805 (dissenting opinion), for a situation where the plaintiff has not yet decided to sue a person whose name, address and involvement are known to the plaintiff.

Even when the SEC changed its mind and decided to sue Leati and Lombardfin in the Fall of 1985 (SEC Br. at 5; SEC App. Br. at 14), it chose not to attempt to serve them with a summons and complaint naming them as defendants. Instead, the SEC chose to wait until the eve of trial and, through the guise of a motion to amend the caption of the complaint, proceeded as if petitioners had been defendants all along, relying on the publication to unnamed purchasers three and one-half years earlier placed in the *International Herald Tribune*.

Not only was the publication order unconstitutional, but it was improper under Rule 4 of the Federal Rules of Civil Procedure. The SEC has admitted that the publication did not include a complaint (SEC Br. at 10 n.6) and, thus, that Judge

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[4] The publication itself refers to Lombardfin as one of the brokers through which the intended defendants had purchased the securities. (Pet. App. A106-A107).

[5] The SEC is mistaken when it says that petitioners do not claim the finding of liability was clearly erroneous. (SEC Br. at 17 n.14). Petitioners so argued to the Second Circuit. (App. Br. at 21 n.16). While the SEC further contends that the Court of Appeals' ruling should not be disturbed because liability was conclusively established, due process requires more than an *ex parte* proceeding at which out-of-court statements taken without cross-examination are offered as proof of liability.

Pollack's order authorizing service by publication of a summons without a complaint failed to meet the requirements of Fed. R. Civ. P. 4(i)(1)(E).[6] The SEC mistakenly seeks to characterize the order of publication as one authorized by Fed. R. Civ. P. 4(e).[7] That rule, however, is limited in its applicability to orders of service which are expressly authorized by statute.[8] Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (1982), is not such a statute. It does not expressly authorize the issuance of any order regarding service. Thus, the order of publication

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[6] The SEC apparently claims that the requirement of service of a complaint was effectively satisfied, notwithstanding the admitted absence of a complaint because, it maintains, the publication notice sufficiently described the allegations of the complaint. (SEC Br. at 10 n.6). Even if the complaint requirement of Rule 4(i) could ever be satisfied in such a manner, the publication notice in this case can in no way be considered the equivalent of a complaint. It contains no allegations of any activity in violation of any law. All it says about the nature of the case is that the action is one "alleging violations of [securities law provisions] . . . , which provisions, *inter alia*, prohibit the use of material, non-public information in connection with securities transactions." (Pet. App. A107) (citations omitted).

[7] Rule 4(e) provides that "[w]henever a statute of the United States or an order of court thereunder provides for [extraterritorial service] . . . service may be made under the circumstances and in the manner prescribed by the statute or order, or, if there is no provision therein prescribing the manner of service, in a manner stated in this rule. . . . " Fed. R. Civ. P. 4(e).

[8] *See* Advisory Committee's Note to Proposed Amendment to Rules of Civil Procedure, Rule 4, Subdivision (e) (1963), *reprinted at* 31 F.R.D. 628 (1963). As has long been recognized,

> "[t]he words 'order of court' must be understood as limited to orders authorized by a specific federal statute. . . . The court is not given blanket authority to enter its rule or order for substituted service or for personal service beyond the state. And the rule does not sanction departure from standards of notice and publication prescribed by statute . . . ."

1 Barron & Holtzoff, Federal Practice and Procedure 731-32 (Wright ed. 1960) (footnotes omitted). Thus, Rule 4(e) does not provide independent authorization for service; it merely continues the effectiveness of certain federal statutes which might otherwise be superseded by Rule 4, "rather in the nature of a saving clause or exception." *Id.* at 729.

was not an order within the meaning of Rule 4(e) and was, accordingly, not authorized under that rule. Nor was the publication order authorized under any other provision of Rule 4 or by statute. (*See* Pet. at 13-18).

C. This Ruling, If Not Vacated, Will Be Precedent For Further Avoidance Of The Constitutional Requirements Of Effective Service Of Process

One of the mandates of due process as it relates to civil litigation is that the defendant be given the most effective notice reasonably possible that he has been named a defendant in order that he has the opportunity to defend, including the right to confront and cross-examine witnesses and to interpose affirmative defenses. There can be no constitutional taking of property absent such notice. The ruling below makes a sham of those constitutional protections. While the SEC argues that this case does not warrant certiorari because there is no conflict in the circuits, it must be recognized that, given the clear rulings by this Court in *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), and *Mennonite, supra*, it is not surprising that no other court has chosen to disregard this mandate. The SEC argues that this case is unique and is not likely to be repeated by it because of the signing of various bilateral memoranda. (SEC Br. at 9, 14-15). While petitioners do not agree with this point, it must be recognized that these petitioners have been denied their constitutional rights, reason enough to grant certiorari, and that this case, if not vacated, will be precedent for other litigants, both public and private, to find ways to convince a court that they also should be excepted from the requirements of *Mullane* and *Mennonite*.[9]

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[9] The Second Circuit stated that the publication was reasonable because petitioners were "members of the securities industry" and could be "expected to be aware of a publicly announced SEC investigation." (Pet. App. A17). However, as this Court stated in *Mennonite Board of Missions, supra*, "[p]ersonal service or mailed notice is required even though sophisticated creditors have means at their disposal to discover whether property taxes have not been paid and whether tax-sale proceedings are therefore likely to be initiated." 462 U.S. at 799.

II

THE ARGUMENTS CONCERNING THE HAGUE SERVICE CONVENTION, THE "MISAPPROPRIATION" THEORY AND LACK OF AUTHORIZATION BY STATUTE OR RULE FOR SERVICE BY PUBLICATION ARE PROPERLY BEFORE THIS COURT

The SEC contends that petitioners improperly refer to the Hague Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters (the "Hague Service Convention"), *done* Nov. 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638 (SEC Br. at 11 n.7) and to the "misappropriation" theory of liability under SEC Rule 10b-5 (SEC Br. at 17), arguing that they were not presented to the Court of Appeals. Further, the SEC contends in passing that petitioners' arguments concerning lack of authorization by statute or rule for service by publication were not raised below. (SEC Br. at 9). All these arguments constitute enlargements of arguments made in the Second Circuit and may properly be considered by this Court. *Dewey* v. *Des Moines*, 173 U.S. 193, 197-98 (1899); *Raley* v. *Ohio*, 360 U.S. 423, 437 n.12 (1959).[10]

Consideration of whether the Hague Service Convention should have been used to effect service of process is fairly comprised within petitioners' due process challenge to the district court's order permitting service by publication. (App. Br. 12-17). This Court is entitled to consider that a ratified treaty, to which the United States and Italy were parties, was in effect setting forth the appropriate method for international service of process. Reference to the Hague Service Convention bolsters the assertions made below that the SEC could have served Leati and Lombardfin personally had they ever attempted to do so. Accordingly,

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[10] The fact that these issues were not mentioned below by "book and verse" does not preclude their review by this Court. *Eddings* v. *Oklahoma*, 455 U.S. 104, 113-14 n.9 (1982).

consideration of petitioners' argument concerning the Hague Service Convention adds greater specificity to the due process defect raised and dealt with in the Court of Appeals, and it is properly before this Court.[11] *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155, 159 n.5 (1980). Similarly, the argument concerning the lack of authorization by statute or rule for service by publication in this case also adds greater specificity to the due process defect raised below.

The reference in the Petition For A Writ Of Certiorari to the "misappropriation" theory is an enhancement of the argument made below that mere possession of information does not give rise to a duty to refrain from trading. (App. Br. at 19-31). Petitioners argued to the Second Circuit that there was no *scienter* proved against them because they were unaware that Giuseppe Tome was conveying material nonpublic information obtained improperly by him as a result of his relationship to Joseph E. Seagram & Sons, Inc., the classic application of the "misappropriation" theory.

The fact that the "misappropriation" theory was not squarely attacked in the context of petitioners' argument on the lack of *scienter* is understandable in light of both the fact that Tome himself, the alleged "misappropriator", was not even before the Court of Appeals, his appeal previously having been dismissed, and the fact that the Second Circuit had consistently approved the "misappropriation" theory. However, particularly if the court grants certiorari on the service of process issue, it would seem proper in light of *Carpenter* v. *United States*, 108 S. Ct. 316 (1987), that the "misappropriation" theory be presented as well since without it there could not have been any *scienter*.

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[11] While the grant of certiorari in *Volkswagenwerk Aktiengesellschaft* v. *Schlunk*, *cert. granted*, No. 86-1052 (Oct. 13, 1987) (argued Mar. 21, 1988), confirms the importance of the issue of the exclusivity of the Hague Service Convention, that case does not raise the issue presented here of whether, given the Hague Service Convention, the SEC was free to seek an order directing publication abroad.

CONCLUSION

For the reasons set forth in this reply as well as those set forth in the Petition For A Writ Of Certiorari, this Court should grant certiorari to review the constitutionally defective judgment entered against petitioners Leati and Lombardfin.

Respectfully submitted,

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